FARM CREDIT CONDITIONS IN A COTTON STATE

Texas is a cotton state, having a relatively sparse population, a high percentage of tenant farmers (53 per cent), and a negro element which averages over 25 per cent in the majority of the cotton counties. Moreover, Texas is industrially a new and undeveloped state. The presence of much risk is attended by a large measure of speculative spirit. Everywhere there is talk of rising land values, which causes speculative land holding and retards economical farming. The element of risk, too, is increased by the frequency of crop failures on account of drought and frost. Other elements in the general situation are a homestead exemption law which, by making two hundred acres execution proof, often prevents the use of land as security for loans; and a law requiring the taxation of mortgages which operates to increase the borrower's interest rates.

While many ventures fail, those that succeed pay well; and the state is growing at so rapid a rate that much capital has to be attracted from other sections by high interest. As a result, the interest rate on commercial loans averages a little over 8 per cent, running from an infrequent minimum of 6 per cent up to 12 per cent in some sections. Now, farmers as a rule pay higher interest than the commercial classes, for the latter generally have a standing that is more readily known, maintain larger and more regular balances, possess more liquid assets, and settle more promptly. What, then, are the facts concerning farm credit conditions in Texas?

Bank Credit

On the basis of the material available to the writer,[1] it appears that only about 4 per cent of Texas farm owners do not borrow from banks, or, in other words, about 95 per cent do. Nor do these loans come at irregular intervals. The great majority borrow year after year—are perennials, so to speak. The most

[1] This investigation is based upon reports made by farmers, bankers, and merchants, nearly all in central and eastern Texas. Over one hundred loans were reported to the writer by farmers from 35 counties; twenty bankers wrote from 15 counties; and a half a dozen merchants from as many counties gave information. This mass of data was then checked against the impressions of several well-informed bankers and farmers living in Austin. Internal evidence to the correctness of the data is borne by the fact that the reports of farmers and bankers for the same counties are in substantial agreement. It is important to note that the data are selected to some extent in favor of con-

common answer to the question, What per cent of your borrowers ask for accommodation year after year, was 75 per cent; the next most common reply was 90 per cent, or "nearly all"; only one went below 50 per cent.[2] The data show a rather close correspondence between percentage of "perennials" and loans to tenants, for tenant farmers are nearly all repeaters.

The one great purpose of most farm loans in Texas is to help "make the crop." The usual items involved in making a crop are labor (chopping and picking cotton), feed, seed, groceries, and perhaps mules. Nearly all short-time loans are for this purpose, and about 85 per cent of the longer ones. Other purposes for which Texas farmers borrow from banks for short periods are: commercial and trading transactions, holding cotton, accommodations to tenants, and extensions of preceding loans for the purpose of tiding over the farmer after a bad year or till a late crop is gathered. About 15 per cent of long loans are for investment and improvements, involving such items as land purchase, stock, buildings, and machinery.

By comparing a group of the loans over $1,000 with a group of $50 loans, it appears that the majority of the former are for "improvements," with purchase of machinery or land next in order; while most of the latter are for making crop, with labor, feed, and seed as the main items. The latter are also applied not infrequently to the purchase of mules, plows, and to making improvements. One eighth of the small loans were clearly for the purpose of consumption.

Taking into consideration all loans upon which this study is based, the average sum borrowed by Texas farmers from banks is a

servative results, for they are largely drawn from the more progressive and intelligent farmers. Moreover, it is more than probable that in many cases the interest rate was reported as what it would have been had interest not been deducted from the principal in advance. All but 5 of the counties covered have a high percentage of tenancy; all raise some cotton, though 5 produce relatively little; two thirds have over 12 per cent of negroes, and a majority have 25 per cent or more. Travis, McLennan, Harrison, Navarro, Milam, Williamson, Lavaca, and Nueces counties are among those for which most satisfactory data were obtained. The approximate date is to be taken as 1912.

[2] On this point considerable variation exists among different counties, depending on the degree of industrial development. Thus, partly developed sections will show 95 per cent of "perennials," while a well-developed German and Bohemian section, like that around Moulton in Lavaca county, will show only 5 per cent.

little over $500. If those loans of unusual size which are made for such purposes as purchasing land and making permanent improvements[3] are deducted, the average loan is about $300. This conclusion is borne out by the estimate of the bankers, who report that loans to farmers usually run from $100 to $300 and rarely exceed $500.

The questionnaire sent to farmers called for the amounts of the largest loan and the smallest loan secured from a bank. The returns show that the average Texas farmer's largest loan is approximately $1,000, and his smallest loan is about $100. Of course, these amounts varied greatly, the largest loans running from $70 to $6,000, and the smallest from $5 to $2,000. Examination of the frequency distribution of the size of the loans shows the most common loan to be $50, and that 45 per cent of the loans do not exceed $100.

The returns from farmers show that the average time for all loans is seven months (the large loans averaging nine months, the smaller ones four months). The bankers in their answers show an average duration for all loans of six months, which is also clearly the mode for their data. If we separate the long-time loans (over six months) from the short-time loans, we find that the average period for long-time loans is nine months, while three months is both average and mode for short-time loans. Probably less than 5 per cent of loans to farmers are for over nine months.[4]

The great majority of the secured bank loans to farmers are made on chattel mortgage security. Perhaps such security is required in about 90 per cent of those cases in which security is demanded at all. Personal endorsement is next most common, being the only security given in about 10 per cent of the cases. A chief item in the chattel mortgage security is mules.

Not a few loans are made without security, generally, of course, to substantial land-owning farmers. The writer asked the bankers what proportion of their short-time loans are secured. The answers run all the way from 15 per cent up to 100 per cent. From 75 per cent to 90 per cent seems most common. The state banks show a smaller percentage secured than the nationals.

Real estate security is a knotty point for bankers in farming communities. State banks in Texas are allowed to take a certain

[3] These loans average over $2,000 and run from $450 to $6,000.

[4] Farmers generally borrow in the spring (February-April) to pay from the autumn crop.

amount of real estate as security for loans and do so; but, as every one knows, national banks are prohibited by law from doing this. As a matter of fact, national banks do take some land as security, and over one half of all banks reporting held farmers' personal notes secured by real estate. Such loans appear to make from 1 per cent to 10 per cent of the total. Sometimes, if a borrower has real estate notes they are put up in national banks, and although they are not pledged for security, it is understood that they are in the bank for that purpose. If a national bank has good customers who have real estate paper, it will frequently take their notes for collection on the understanding that when collected these notes will be applied on the payment of their obligations to the bank. Occasionally, too, national banks take a real estate loan as collateral security when the maker of the land note has other property subject to execution and the land does not have to be depended upon for the liquidation of the debt. It seems that national bank examiners are familiar with this fact and that the practice has been tacitly sanctioned, perhaps to check lending without any security at all.

Such being the conditions surrounding farm credits, what is the interest rate? Here we find some discrepancy between the reports of the bankers and those given by the farmers. The bankers' returns, when averaged, give a rate of 10.07 per cent. The most common rate shown is 10 per cent. Their reports can be analyzed so as to distinguish long and short loans, and, when this is done, the long-time rate is found to average 9.3 per cent, while the short-time rate stands at about 10.8 per cent.[5] In several counties the rate is clearly 8 per cent; but in others it is 12 or 15 per cent. About one third of the bankers indicated a maximum of over 10 per cent—the legal rate!

On the other hand, the farmers' statements give an average interest rate on all loans of 12 per cent. Interest paid on large loans average 10.7 per cent; on small loans, 13 per cent. Examination of all loans of $50 or under shows an average interest rate actually paid by farmers of 15.6 per cent. The most common rate, however, is 11.1 per cent, arrived at by paying a nominal rate of 10 per cent, which, being deducted from the principal in advance,

[5] The Bureau of Statistics of the Department of Agriculture recently collected data from country banks on loans running from three to six months, and found the rate to be 10.03 per cent for Texas in 1912.

makes the actual payment on the cash received equal 10 per cent plus 1.1 per cent.

What has been written thus far, concerns the average run of ordinarily prosperous white farmers, mostly owners. In a state, however, in which 53 per cent of farmers are tenants, more weight must be given to the less prosperous tenant farmer.

To what extent do banks handle tenant loans? In the cotton counties, with but few exceptions, from 25 per cent to 75 per cent of the number of loans made to farmers by Texas banks are made to tenant farmers. The great majority report 50 per cent or more of loans to tenants. The more common percentages appear to be 50 per cent and 75 per cent. The percentage, of course, refers to *number* of loans, and the amount of loans to tenants would be a much smaller percentage—perhaps 5 per cent. Also, it is to be remembered that the data are mostly from small banks in small towns. The proportion of tenants who borrow from banks varies with the character of the tenants, being greatest in counties in which prosperous foreigners are numerous.

(1) The tenant farmer usually borrows simply to provide teams, implements, and supplies for making a crop—supplies for teams and family making the largest item. (2) The average tenant farmer hardly finds it necessary to borrow at any one time more than $500. In fact, his various separate loans are generally less than $100,—$50 and $75 being very common; and his aggregate borrowing during a year will run from $200 to $600. (3) Tenant farmers' loans are usually made in the winter or spring to be repaid the following fall or winter, and so average from seven to nine months. (4) As security, tenant farmers generally give a chattel mortgage on teams, stock, implements, and crops. Not infrequently they offer the personal security of the landlord or of some friend acceptable to the lender. (5) The statistics already cited concerning interest rates on small loans apply to tenant loans. In progressive cotton counties, tenant farmers with good standing and acceptable collateral can borrow from the banks at from 8 to 10 per cent. Otherwise, and in dealing with outside parties, they may pay from 10 to 30 per cent.

Store Credit and the Tenant Farmer

A majority of the tenant farmers find in the country merchant their chief source of credit; and store credit and crop mortgage arrangements form a dark place in the Texas farm credit system.

Virtually all negro tenants, and 75 per cent to 90 per cent of the white tenants, foreigners and the best black-land tenants excepted, regularly depend upon advances of credit from the local storekeeper for food, clothes, and various supplies, and give mortgages on their crops as security. Probably less than 10 per cent of farm owners are accommodated in this way, and the percentage of white tenants seems to be on the decrease in most sections. The *nominal* interest rate is always 10 per cent.

The system usually works as follows: At the end of the year those who have secured advances on a crop mortgage have little or nothing left. One of them will go to his merchant about February 1, and ask for credit until he can make a crop in the fall. The merchant will agree to extend a certain amount of credit in return for a mortgage on the prospective crops of the tenant and any other property which he may own—which is often nothing. Often the acreage in cotton is considered, and whites may be allowed about $5 an acre and negroes from $3.50 to $4.00. Generally, however, the amount is not formally figured in this way, but a maximum allowance per month is set, being about $30 for whites, and somewhat less for negroes. The amount varies with the community, and may run up to from $60 to $75 a month in a German community. As low a limit as $15 may be set. It depends on the character of the tenant and the number of his teams. The aggregate amount for the season, then, is the product of the monthly allowance and the number of months, say nine months. The character of the security is indicated by a crop mortgage form which accompanies the farmer's note.[6]

[6] THE ABOVE OBLIGATION [the note] is given in settlement for goods, wares and merchandise furnished to..............by said..............for the purpose of enabling........ to make a crop for the year 19..., and without which advances it would not be possible for............to make a crop; and it is hereby agreed, in consideration of the premises, that the above amount, together with any further advances hereafter made to..............upon conditions herein named, are intended and shall operate in law as a perfect and bona fide LIEN upon all such crops, either CORN or COTTON ....as may be grown upon........farm........in.............. COUNTY, TEXAS, the present year.

And upon default on........part to pay the above described obligation when due, out of the first of the proceeds of said crops, it is agreed and understood that the said...............may enter upon the said premises and take possession of the said crops, or such portions of the same as may be sufficient in amount to discharge and pay off this obligation and such necessary expenses as may be incurred in collecting the same. This is the only encumbrance upon the above described crops.

WITNESS:........................... ....

This crop mortgage system is satisfactory to no one but the dishonest storekeeper—not all storekeepers are dishonest.[7] The interest is nearly always deducted in advance, and it is almost universally complained that the borrower is overcharged for his goods. If the farmer borrows $300 he gets only $270 in cash, and is given the worst bacon and flour at the price of the best. Once the mortgage is given, the tenant becomes the storekeeper's man; for he must depend on credit, and all his credit is pledged. He, or his trade at least, is regarded as the possession of the merchant who holds the mortgage on his crop. Then, at the end of the season, he is not infrequently virtually compelled to sell his cotton to the storekeeper, and as a result often fails to get its full value.[8] The same is true of the farmer's other market produce, such as chickens and eggs. The total actual interest paid under such circumstances averages at least 20 per cent. On the other hand, the tenant is often a shiftless and unreliable person and the percentage of bad debts is high. Not unfrequently the merchant has to carry the farmer over for another year on account of crop failure. In this way a big sum of debt accumulates, and, in order to cut a long debt short, the tenant "pulls up" and leaves the country. All this is true, to say nothing of the social harm done by the continuous planting of a single crop (cotton) which the system demands.

Here some one asks, why do farmers ever go to storekeepers? Why do they not get cash from the banks, and buy on a cash basis?

The reasons are numerous and cogent. (1) The banks do not like long loans and often refuse to make them; the tenant wants credit for nine months. (2) From August to January it is generally hard to get money at the banks; the tenant wants some one to run him through the whole year. This the storekeeper will do. (3) The banks do not want to make small loans; the tenant wants no other. (4) Too much security is required by the

[7] See *Studies in Agricultural Economics*, Bulletin of the University of Texas, No. 298, pp. 5-10.

[8] This statement applies as a general rule to the more ignorant classes only. In some cases the storekeeper actually offers a slight advance over the market price for the cotton as a premium to induce the farmer to sell to him, his reason being that by securing the farmer's cotton business he can secure payment of the mortgage obligations out of the price of the cotton. Of course, any such premium must be an expense of the business and ultimately be borne by the farmers.

banks; the tenant often has nothing to pledge that is not bought on time. (5) Banks generally will not take crop mortgage security. (6) This kind of credit business requires close local supervision, even to the extent of directing the tenant's farming operations in not a few cases, and such intimate knowledge and care the banks cannot give.

In a very real way, however, the *country merchants act as the banker's agents in making crop mortgage loans*, the business being farmed out to them, as it were. From 5 per cent to 20 per cent of the loans of many Texas banks are made to country merchants, such loans being "largely" or "almost entirely" used to carry farmers on crop mortgage security. The interest paid is usually 8 per cent. As security, the merchants endorse and turn over to the banks the farmers' notes and crop mortgages. They do not, however, receive dollar for dollar on such security. In this way, indirectly, the banks carry a larger part of tenant farmers than would at first appear to be the case.

About two thirds of the sales made by hardware and implement dealers to Texas cotton farmers are on time to be paid out of the cotton crop in the fall. The credit price is higher than the cash price by an amount which varies with the interest rate but which may safely be put at 10 per cent. In the case of unreliable farmers and tenants, a mortgage is taken on the article sold and the purchaser gives his note.

The Landlord as a Source of Credit

It is probable that in most parts of central Texas over 90 per cent of those tenants who owe the store are also indebted to their landlord for larger or smaller advances. Storekeepers, as such, only give credit on food, supplies, implements, etc., whereas cash or its equivalent is often needed for mules, feed, and other current expenses. The landlord is practically always involved in supplying this cash. He may make small cash advances in a bad season; and he often sells his tenants teams and feed to be paid for out of the crop. But for larger cash advances the practice is not uniform. In the bottoms of the Brazos and Colorado, and in a few places in the "black-land belt," there are large "plantations" whose owners prefer as a rule to "accommodate" their own tenants rather than to "stand for" them with the bank or other lenders. This gives them greater control over their tenants, and unscrupulous landlords may make larger profits by charging high rates. To

carry their tenants they may borrow several thousand dollars from the bank each year. Such landlords often make a business of running a sort of commissary.

On the other hand, the owners of medium and small farms in the black-land belt and sandy regions to the east do not lend any considerable amount of cash to their tenants, though they sometimes help them to borrow elsewhere. On the whole, they would rather the tenant would get his money in his own way.

Evils and Needs of the Farm Credit Situation

Already the reader will have reflected that grave evils exist in the farm credit situation in Texas. First, as to bank credit, remembering that landowners are chiefly though not entirely concerned. Perhaps the most obvious objection is that the interest paid is excessive. One cannot but wonder if it would not be difficult to make money on funds for which 11 per cent is paid; and one feels certain that ruin awaits the farmer who tries to do business on 15 per cent money. That Texas renters are not very prosperous is evident from the organized discontent which has of late found expression among them.[9] The methods used to defeat the 10 per cent interest rate are numerous and efficacious. Almost universally the interest is deducted in advance; even among bankers, only 4 out of 22 deny this. Then, the loans are often made for short periods—one to three months—when renewed interest is again deducted, thus virtually being compounded. It is common for the farmer to pay all expenses for making, filing, and recording papers involved in loans. Again, in addition to a high interest rate, a discount may be charged on the farmer's note, which if it is 2 per cent, may bring the rate paid up to 12 per cent. It is also common on small loans to demand a lump sum in payment, which, though not expressed as a percentage, may perhaps amount to 50 per cent. Thus, suppose a farmer borrows $25 to buy feed, the loan running three months, and that he pays $2; the interest rate is 32 per cent. Or if he pays $5 for a loan of $50, which runs six months, his money has cost him 20 per cent. Sometimes a cash bonus is demanded in addition to the regular interest rate. Finally, it is by no means infrequent to ask 10 per cent on a loan which runs for less than a year, 1 per cent a month being common. The law says 10 per cent *per annum*. To demand

[9] Scores of local "renters' unions" exist, and, under socialistic influences, have united in a state organization.

10 per cent on $300 for nine months is to take $30 where only $22.50 can legally be required. Other devices of which I am ignorant may also be used.

The situation is summed up by the representative of a McLennan county national bank as follows:

> The majority of the small banks have no regular rate of interest and they usually add 10 per cent to the face of all notes running from eight months to a year, so that they collect a years' interest on notes running eight and nine months. Twelve per cent is usually charged on notes running a year. A great many notes, where they are purchased outright, are discounted at even a greater rate than that. However, it has always been my policy to charge the farmer 10 per cent on money for actual time the note had to run, as I have some scruples about charging a greater rate than the law provides.

Two equally common complaints, which we may consider next, are too short a loan period and too much security requirement. On the first point the interests of the farmer and those of the commercial bank are plainly in conflict. The farmer sometimes needs loans for improvements which cannot pay for themselves inside of several years. More than this, for ordinary working expenses he often needs advances, and when he does he needs them for the length of the crop season. Cotton requires a long growing season and the marketing comes late in the fall, the result being that the Texas farmer generally needs credit for nine months. But bankers, in their desire to keep assets liquid, often refuse loans of over three months and rarely make them for over six months. To be sure, the sixty- and ninety-day accommodations may be renewed, but that is not absolutely certain; it means some trouble, and affords an opportunity for exacting a greater interest payment. One result of short loans is that the cotton may be forced upon the market at a disadvantageous time; for the farmer cannot hold it without support. Even six- and seven-month loans are not always satisfactory, for they are made to mature October 1, while often the cotton cannot be got out by that time, and in any case it may take all the first cotton money to pay pickers, etc. The result is that the farmer is forced to seek an extension in the height of the crop-moving stringency.

One of the chief difficulties of the tenant and the small farmer lies in the security demanded by banks. This does not necessarily imply criticism of the banks, but simply an inherent impediment in the activities of commercial banks as directed to the needs of farm credit. One farm owner states that banks want security to

the value of from two to three times the amount of the loan. Another reports having given $15,000 worth of land as security for a $5,000 loan. Another gave $100 personal security for a loan of $20; still another pledged two bales of cotton for $50. The merchant will lend only $10 on two cows, for that would be the value of their hides if they should die; and so on. Of course, the tenant is apt to have no security but his growing crop, and some landlords complain that they have to give unreasonable security for loans to tenants, up to three and four times the value of the loans, for they must vouch for their insurance, etc.

On the score of ability to obtain loans at banks, farm owners and prosperous tenants make little complaint. Only 15 per cent of those questioned said that they could not always secure cash when wanted, and all of these indicated by the high interest paid that their standing was not the best. Of course, from August to January money is tighter; and, as the banks like to care for their more regular commercial customers first, the farmers may experience difficulty in getting loans during those months.

The credit conditions found among the great mass of tenants who receive advances from country merchants on chattel mortgage security are worse than the preceding. As already stated, the interest paid will average at least 20 per cent and at that rate progress and ownership are all but impossible. Bad years submerge such tenants. Borrowers on crop mortgage in Texas generally receive but 50 per cent of the estimated value of the crop, so that their borrowing power even at high rates is very limited. Under such circumstances the tenant is forced into a condition of so great dependence upon the person who "carries" or "runs" him that he loses initiative and hopefulness. The merchant, in order to secure himself, generally specifies that cotton shall be the main crop with perhaps a little corn for feed; and in this way strongly reinforces the tenant's inertia in the matter of diversification. The crop mortgage system, while largely an outgrowth of the tenant-cotton régime, now keeps that régime fastened upon the South; and the existing credit system is closely bound up with the single crop practice and soil exhaustion. In other ways, too, the credit system makes for poor farming. For one thing, the motive for good farming is taken away when everything the farmer owns or hopes to own is going to pay debts and capital-eating interest rates. Again, the tenant and small owner often have no means to get adequate land and capital to

utilize their labor properly. There is tremendous waste all through the South due to a failure to utilize labor power to its fullest extent. A man and family require a certain minimum number of acres, mules, and dollars' worth of machinery in order to make the maximum net return, and the average Texas farmer badly needs more farm animals and machinery.

While more live-stock on the farm is a great need, the one-crop system is opposed to animal husbandry. This is partly due to the lack of time to devote to feed crops, and partly to the specialization by merchants and bankers of the credit system for the cotton industry. While cotton allows annual settlements, the live-stock business requires accommodations of at least two years.

Can Existing Agencies Supply a Remedy?

Among the existing credit agencies available to farmers the country bank holds out most hope of improvement. For obvious reasons it is not practicable to prohibit disadvantageous credit operations by storekeepers and landlords. Here education and public opinion alone can avail. But the banking fraternity is apt to insist that nothing is needed but what it is supplying or is about to supply. What ground is there for this optimism?

It is to be noted, in the first place, that most Texas banks desire the farmer's credit business; and not a few make an effort to get it by such means as making mailing lists of farmers in their respective counties and sending them advertising matter. This, of course, concerns only farmers of good standing, and is not designed to reach poor tenants. While normal loans as low as $25 are made by some banks, they are not profitable nor desired. On the other hand, there is no doubt that in many instances farmers either are loath to visit the bankers for small amounts or find it inconvenient to make the trip to town when the loan is needed. That the banks are not meeting the situation is proved by the large amount of lending by individuals and storekeepers on real estate and chattel mortgage security.

Perhaps the most notable achievement in the way of improving farm credit is the scheme for holding cotton devised by a committee of the Texas Bankers' Association and approved by the Farmers' Union. Briefly, the plan is as follows. The owner of cotton can place it in a warehouse and upon this security obtain $35 per bale as a cash advance from the bank. He gives the bank his note, promising to pay in six months at 6 per cent, with 10 per cent after

maturity and 10 per cent for attorney's fees in case of judicial action. In the note it is recited that the maker has deposited the cotton as security and that if the price of cotton falls below 8 cents per pound (middling basis) additional security satisfactory to the bank must be given, or the bank can take possession of and sell the cotton and apply the proceeds to the payment of the note, including insurance and warehouse charges. As there are 500 pounds in a bale of cotton, the 8 cents gives $40, or a $5 margin above the amount advanced.

This note is to be accompanied by a uniform public warehouse receipt stating that a certain number of bales of cotton of a certain weight and class have been deposited by the borrower and will be kept under shelter and insured until the note is paid. The warehouseman also certifies that the borrower is the owner of the cotton and that it is free from any lien or encumbrance. Also, the plan involves a bond to be signed by a number of the borrowers' neighbors who bind themselves to hold the bank "harmless against any loss it may suffer by reason of such loans or the failure to collect any note." By such means it has been hoped to make the paper based on cotton acceptable in the eastern money markets.

As yet, however, farmers have made but little use of this source of credit. One objection is that it requires leaving the cotton in the warehouse for too long a period of time, thus failing to allow the farmer to sell at any high price within six months after making his crop. Obviously, this plan might be of considerable service in case rather low prices were prevailing for cotton and it were feared that throwing more on the market would break the price further. But it hardly touches the tenant-storekeeper problem, nor the need of farmers for working capital; and it has no bearing on the need for long-time loans for investment and improvements.

Again, Texas bankers express willingness to help farmers who will join forces for the purpose of helping each other in borrowing. If the farmers will give them good paper signed by eight or ten of their number, they will make loans for productive purposes, such as improving herds, constructing silos, etc., at 6 or 7 per cent, the loans to run six months, with the privilege of renewal upon making a reasonable payment of, say, one fourth. This might enable substantial farmers to make permanent improvements, but is subject to the renewal contingency and is pretty exacting in the security requirements.

The only way that existing commercial banks can handle long-time loans is through the extension of short loans, and it is not uncommon for Texas farmers who maintain good balances to be carried from year to year when making loans for investment purposes. Only the more substantial farmers, however, can count on this.

In practice, landowners often can obtain accommodations without any security if their business and balance warrant such favors in the judgment of the bankers. The fact that national banks in practice are able to take real estate security to a small extent has also been noted. This, of course, affords only slight relief to the difficulty experienced by farmers in borrowing on land. The state banks can lend on land, subject to certain restrictions on the amount, and do so without impairing their solvency. I agree with Professor Kemmerer in advocating some relaxation of our present national banking act in the matter of loans on real estate.[10]

Finally, it seems quite feasible to better conditions by improving the rediscount market for farm paper. One way would be to introduce by appropriate legislation some means of marketing farm notes which have been "accepted" by local banks.[11] This would involve the authorization, by law, of banks to give "acceptances," and the establishment of some central organization to handle the paper (bills of exchange) sent up by small banks. By some such means, the loaning power of the banks of the nation—the discount market—might be pooled. If the local bank were "loaned up," it would "accept" the farmer's bill and send it in to the central association to be disposed of to members who might have loanable funds available. Or, if authorized and the central machinery provided, the existing banking system could take farmers' notes and get them discounted by correspondents. Such a plan might be of much service; but it would have to be carefully safeguarded against inflation of credits, and in any case the loans would have to be of such short duration—probably three months, and certainly not over six—that the farmers' needs could not be entirely satisfied; and, as in the other schemes, only substantial persons who now have least difficulty would be benefited.

[10] See AMERICAN ECONOMIC REVIEW, vol. II, no. 4 (December, 1912), p. 870. The recently passed currency bill increases the power of national banks to make loans on land.

[11] See *Proceedings of the First National Conference on Marketing and Farm Credits*, p. 168. The new currency act provides for the rediscount of agricultural paper running 6 months.

Can Coöperation Supply the Remedy?

As to land-mortgage coöperation, we need simply note that not only is it less urgently needed than another kind, but the homestead exemption law makes it almost impossible.

When we come to examine the chances for successful personal credit associations, the difficulties raised by the character of the farm population are formidable; for more dependence must be placed upon the capacity and judgment of members while at the same time less intelligent classes must be dealt with.

It seems that the negro population must be left out of consideration for the present. In most parts of the state the negro would be excluded from organizations of whites, and it is more than doubtful if negro credit associations could succeed. Also, a part of the poor white farmers are beyond the reach of coöperation on account of their migratory habits and thriftlessness. It is the writer's well-considered opinion that fully 10 per cent of the white tenant farmers of Texas are hopeless—cannot get good credit by any means.

Some of the adverse conditions affecting the majority of the whites are as follows: (1) There is a large element classed as "poor whites," a shifting and shiftless group; 5 per cent of the native white males in the rural population are illiterate, and 31 per cent of the foreign-born white males; while only 44 per cent of the native white rural children are attending school. (2) These people are largely short-time tenants. (3) The one-year lease is almost universal, and under it tenants commonly are migratory and take no interest in scientific farming. So shifting a population is seriously handicapped in developing that mutual acquaintance and trust which may come in more stable groups. (4) It follows that farmers are deficient in disposition and training for team work and do not easily pull together as coöperation requires. (5) Finally, a speculative spirit pervades even farming operations and is opposed to the spirit of frugal saving which must attend the successful operation of credit unions.

Many native Texans are not efficient farmers, a fact which is clearly demonstrated by comparison with German and Bohemian farmers who occupy certain sections of the state. The foreigners get a far larger return per acre, while at the same time maintaining the fertility of their land. As a result, they find no difficulty in getting credit when they need it, though, as a matter of fact, they borrow far less frequently than the native farmers. There

can be no question that the introduction of better farming methods is much needed as a basis for better farm credit.

The strongest argument in favor of personal credit coöperation, however, is probably the educative value of coöperation itself. Efforts in coöperation increase the facility of coöperating. Therefore, assuming the efficacy of successful coöperative credit, we may conclude that the very urgency of the need may warrant the initiation of coöperative organization in spite of great initial difficulties. If the need is great and the difficulties decrease in proportion to the application of the measure, the argument for that measure is strong.[12]

The object of successful credit organization must be to improve such non-transferable productive powers as poor men can possess—strength, skill, energy, and honesty—and to organize and direct them so that they may be used as a basis of credit; and to this basis it may add by making more readily negotiable the small property possessed which is not now accepted as security on favorable terms. Of course, there must be a modicum of the qualities just mentioned to start with.

Stated comprehensively, what coöperation can accomplish in states like Texas is as follows: First, it can reduce the risks of lending in at least six ways. (1) The integrity of the coöperative group can be raised above the average of the class concerned by a selective process. To this end, the area embraced in a single group should be limited, and good standing among neighbors and acquaintances be made a condition of membership. (2) The interests of the immediate borrowers and lenders are harmonized. This is accomplished through the fact that the capital of the coöperative unit is largely drawn from the entrance fees and deposits of farmer members. (3) The credit of individual members is pooled, thereby increasing the borrowing power of each. The pooling is the result of a collective guarantee of loans made to any member, and its effectiveness increases with the extent to which the collective guarantee increases, being at a maximum under unlimited liability. (4) The security of loans can be increased by careful and intelligent scrutiny of the purposes of the borrower in order to insure against loans for unproductive purposes. And, of course, this feature can be strengthened by inspection to see that sums borrowed are applied for the purpose specified. (5) By means of

[12] In this, coöperation has an advantage over the extension of ordinary banking activities, for it has its undoubted educative effects to support it.

local supervision the most productive methods of applying loans can be secured and more skillful farming be encouraged. (6) Finally, the security that farmers have to give can be made more liquid and negotiable. To be concrete, land and cotton are not welcomed by our commercial banks as bases of credit; but by coöperating and pooling such resources and making them the basis of issues of equal, transferable securities of convenient denomination, a ready loan market may be created. Clearly, points 1, 2, and 3 insure improvements in *integrity,* or will to pay; and points 3, 4, 5, and 6 insure greater *solvency,* or ability to pay. These are the very bases of credit.

In addition to the preceding means of reducing risk, it is to be remembered that economy in direction and management of the credit business can be gained by coöperation. By confining operations rigidly to securing credit, and working through small local units, the simplest and cheapest organization is secured. A single central organization can serve as a clearing house for a large area.

The Most Desirable Form of Coöperation

Attention will here be confined to personal credit unions; for relatively short-time loans, largely based on personal security, are the most pressing need in Texas. The great majority of loans are wanted for making crops, and land security is not often available. As preliminary generalizations, I would emphasize three points:

(1) So large an element of shiftless tenants means difficulty in local organization. The weaker the units and the greater the difficulty of successful local operation, the more essential the central machinery and the sooner it should be established in any coöperative experiment. In Texas it should exist from the start, if any extended use is to be made of coöperation, and this probably means that it would have to be set up by the state.

(2) On the principle that it is economical where possible to utilize existing institutions, the use of the chattel mortgage—including the crop mortgage—might well be retained. It may be thought of as a form of security midway between the land mortgage and personal endorsement, and, in the present condition of credit in Texas, might well be retained to supplement personal credit. Also, the state banking system is well developed and working satisfactorily, and it would seem uneconomic not to utilize it to its full capacity in supplying farm loans.

(3) Nor must the technical facts of the agricultural situation be forgotten. Thus, the need of cotton farmers is not to be satisfactorily met by loans for less than nine months in many cases, and accommodation for a maximum period of that length should be authorized. As has been observed, cattle are greatly needed as a part of farming operations in Texas, and this requires credit accommodations of two years' duration. As shown, the average farmer borrows in the neighborhood of $300, and it would, therefore, seem desirable to authorize a maximum loan to any individual of not less than that amount.

Let us now examine the form of organization provided by the law recently enacted in Texas. It is modeled on the Massachusetts law. A minimum of ten citizens may become a corporation and have a capital stock divided into twenty-five-dollar shares. A member may hold any amount of stock, but each member has only one vote. Loans not to exceed $200 to any one member may be made for a maximum period of eight months, at reasonable rates of interest not to exceed 6 per cent. A board of directors, a credit committee, and a supervisory committee are provided for. Other clauses provide that the capital shall be unlimited in amount, and that an annual dividend may be declared from income, after the deduction of expenses, losses, and 20 per cent of net income for a guaranty fund. But the guaranty fund payments cease when the fund equals the capital stock. Adequate provisions concerning accounts and their inspection by the state commissioner of banking are included.

Several objections and shortcomings are at once apparent. As errors of commission, may be mentioned: (1) Limited liability. An incorporated group of poor farmers is not going to be able to command a credit much beyond that which they enjoy as individuals. The educative value of great responsibility is also lost. (2) The size of shares is too large, $10 being a maximum when it is desired to encourage poor men to join. (3) It is dangerous to allow an unlimited capital stock and unlimited individual holdings, as this tends to introduce profit seeking, even though the one-man-one-vote rule obtains. Not more than one fifth of the shares should be held by one person. (4) The payment of dividends is made too easy. (5) The maximum loan is too small and the time too short to meet Texas conditions. (6) A maximum interest rate of 7 per cent should be authorized, the average commercial rate being 8 per cent.

Among the errors of omission are the following: (1) No limitation is put upon the area or maximum number of members embraced within a group. This, together with unlimited capital and dividends, leaves large opportunity for loose, profit-seeking operations. (2) The law might well be more specific in the matter of qualifications for membership. No emphasis is laid upon character and integrity. (3) It is not specified that loans should be made for production purposes. (4) No provision for borrowing by the association is made, and no relation is established between reserve and loans. The latter point is of capital importance; the purpose of a reserve ("guaranty fund") is to serve as a security for loans, and it should be fixed in proportion to liabilities. I believe that all profits should be carried to reserve until the desired proportion to liabilities is attained. (5) No central organization is provided.

However well it may work in Massachusetts, this law is not designed to meet the most urgent needs of Texas. In adopting the limited-liability-share principle it establishes a system which can be effective only among well-to-do farmers of some business experience. It limits loans to short periods, as must be the case where limited-liability shares exist, and the security is more fluctuating than that furnished by unlimited liability. Personal security—which is best in all credit business—is not encouraged, whereas a chief service of coöperation should be to educate and build up personal credit. It is doubtful if share capital will enable sufficient borrowing, while no special inducements seem to be provided for depositors.

The greatest need is working capital with which to make crops, with a less immediately urgent need of farm animals. This need exists more urgently among a large mass of poor tenant farmers. Therefore, the most desirable credit agency is one which can best supplement existing agencies in developing such credit as these farmers have. These facts indicate an organization of the personal credit type, confined to as small areas as is practicable, and operating with a liability that is greater than that of corporation stockholders. The object of coöperative credit is not so much to increase directly the money security as to improve integrity and, indirectly, income and ability to pay.

Recognition of the local situation, however, would seem to indicate some modification of the personal credit idea in making loans to members, temporarily, at least. The chattel and crop mortgage

system is well developed and thoroughly understood, and the existing banking machinery is adjusted to it. It does not lock the money up for too long a time, as is the case with land; and the security if seized is more readily salable. Close local supervision by interested fellow members would insure the best care for cattle, crops, etc. A use of the chattel mortgage would facilitate the securing of funds from commercial banks. Say there are twenty-five members, each of whom borrows $300; their aggregate notes secured by chattel mortgage amount to $7,500. Instead of going to the storekeeper, who now acts as credit middleman between bank and farms (at a rate of over 20 per cent), these twenty-five farmers give their notes to their credit unions, which deal with the bank for them. With unlimited liability, which we are supposing, it is likely that a bank would lend the association the full $7,500 at the lowest commercial rate of interest—and angels could do no more. Even if limited liability prevailed, the association would merely make its note for enough less than $7,500 of mortgages to allow a safe margin, and so, by risking $7,500 for, say, $6,000, the lowest rates might be secured.[13]

Such utilization of chattel mortgage security would make it possible to gain the most from existing banking agencies, which is highly desirable. The country banks of Texas at present extend a wide range of service to farmers and desire their business. The best attitude to take toward coöperative associations is to regard them as feeders for commercial banks. The great source of funds is the same under any credit system. *What coöperative organization should seek is to become an effective credit middleman between latent or ill-used bases of credit among farmers and the funds held in commercial banks.* To replace the storekeeper in the existing system would be a large part of its service.

That a strong central organization is needed under such conditions as prevail in Texas has already been indicated. The law should provide for a central bank to be set up in a modest way as soon as more than one local association arises. An executive committee elected by the locals would be in charge. It should be a joint-stock organization, its shares being held by locals. (Perhaps the state might temporarily make a subscription to its stocks or a deposit of state funds.) The locals, as members,

[13] Evidently this is merely a cross between limited and unlimited liability; for the members assume a liability 20 per cent in excess of the amount borrowed.

should be required to make small regular deposits. Thus, capital would be derived both from stock subscriptions and deposits, though deposits should ultimately be the larger source. The requirement of deposits would incidentally promote thrift among the locals. This central bank through its executive committee would pass on the affiliation of locals, decide the credit to be allowed to locals, and in general serve as a clearing house to accomplish a virtual pooling of the funds of the whole system. It would also audit accounts. Each local, however, should be absolutely free to apply loans in such ways as its members might approve.[14] Real coöperation is essential to coöperative credit.

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[14] Those who are informed on coöperative credit organizations will recognize the similarity of this plan to the one used successfully in India. The chief differences are the chattel mortgage security feature and the use of existing banks instead of specially created joint-stock "district banks."